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CHATTEL SECURITY: I*

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GOODS may be sold for cash, on credit without security, or on credit reinforced with one of the many available security devices.¹ As particular goods move along the channels of distribution they may be sold several times over: by raw material producer to manufacturer, by manufacturer to wholesaler, by wholesaler to retailer, by retailer to consumer.²

Although our law of sales enshrines the sale for cash as the standard transaction, from which all others are in some degree deviational, we

* Part II of this article will appear in the next number of the JOURNAL. The present installment is primarily a descriptive analysis of credit extension, and the security devices of pledge, chattel mortgage and conditional sale. Part II will contain a discussion of trust receipt financing, an analysis of recent statutory developments relating to chattel security and the authors' comments on what ought to be, in so far as it seems to them untrue that whatever is, is right.

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1. The term "security" has a double reference, first to security in fact, the kind of "security" provided by a credit investigation of the person to whom credit is extended, by regular business usages and so on; second, and most important for our purposes, the "security" taken by the person extending credit, in the form of collateral to protect him against the contingency of something going wrong in the transaction, principally the borrower's insolvency. The much discussed problem of the lender's protection against levying creditors is in truth an aspect of the insolvency situation. The focus of security law is not, and ought not to be on the protection of the lender against the borrower's "fraud"; the "fraud" situation itself is likely to be an aspect of debtor behavior on threatening insolvency, or else is too infrequent to be worth bothering about outside the criminal law. Cf. Report of the Committee on a Uniform Chattel Mortgage Act, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 417 (1926): ". . . the draft proceeds on the basis that *the mortgagor's honesty is a credit risk which is undertaken by the mortgagee.*"

2. The phenomenon of multiple intermediate sale is characteristic of small and middle sized business. The giant corporation which has achieved an integrated operation with lines of control from raw material sources to retail distribution points may, for the convenience of cost accountants and the satisfaction of counsel, "sell" and "resell" the goods as they move down the line—to improve a tax position, to preserve a correct corporate independence, to swell an operating subsidiary's rate base, and so on. Such "sales," in which credit terms, security, control and risk are not operative factors, are outside the scope of our subject. Not all big businesses have chosen, or have been able, to carry the integration all the way down the line—the automobile industry, for a notable example. Thus, while insofar as we deal with intermediate sales on credit, the relatively small-gauge enterprise is principally involved, the giant corporation is not entirely out of question.

live, and have lived for a hundred years past, in a credit economy. The true sale for cash exists today principally in connection with the sale of non-durable goods of small value to the ultimate consumer for use, although even such a sale may have a credit background, since the merchant who sells for cash will likely enough resort to third-party financing. And in the intermediate sale between professionals, terms: "net cash" or "cash against shipping documents", the apparent sale for cash may well be a credit transaction in which the buyer's bank puts up the funds, under a letter of credit, guaranty of payment or simple bank loan, against an agreement with the buyer for later reimbursement.

The extension of credit necessarily involves the taking of risks. The risks involved in financing raw material furnisher and manufacturer are not, however, at all points identical; nor, for that matter, is financing the operation of a coal mine the same thing as financing an acreage of tomatoes for canning, or a chinchilla ranch. Dealer finance brings up a special problem: the dealer's stock of goods is held for resale, as quickly as possible, in finished form. Consumer sales on the installment plan present their own peculiar troubles.

Credit may be extended from seller to buyer (delivery in advance of payment); from buyer to seller (payment in advance of delivery); or from a third party money-lender to buyer or seller. Nor is the financing of a single transaction necessarily restricted to one extension of credit, since the financing seller or buyer may in turn be financed by a third party, and so on in a possibly endless series. The position of the third-party money lender is significantly different from that of financing seller or financing buyer: he is a lender of money at interest, and does not share either the profit or the loss of the transaction as a whole. Since he is not a joint venturer in the enterprise, one of his objectives is to isolate himself from liability arising out of the performance of the contracts which he is called in to finance.³ Financing seller and financing buyer, on the other hand, remain necessarily liable for performance of the sales contract.

The lender's principal line of concern, whether he finances raw material furnisher, manufacturer, distributor or consumer, is that the borrower may not pay on time, that he may not pay at all, that he cannot be made to pay, that he is judgment proof. On the other hand,

3. The reader should at this point be on his guard against the attribution to the parties to a transaction of clearly thought out desires and well defined objectives. The legal form in which a business transaction is cast is frequently the result of an uneasy compromise between the business man and his lawyer: one is thoroughly familiar with the business pattern and hazy or ignorant as to the applicable "law"; the other is trained to think primarily in abstract categories and will often have at best an uncertain grasp of the business facts. The joint product of their groping at cross purposes may, by a convenient shorthand, be called the aim or desire or concern of the nominal party.

it is hard to see more than a remote formal similarity between a fifty-million dollar claim in a railroad reorganization and a finance company's claim for the balance due on a fifty-dollar radio. Nevertheless our unitary law, so far as possible, identifies the conditional vendor of rolling stock to a bankrupt railroad with the conditional vendor of the radio, and, formally at least, allocates to each the same quiver of rights and remedies.

We have a law of conditional sales, a law of chattel mortgages, a law of trust receipts. Our legal categories are categories of devices. Their manifest inadequacy may be traced to the lawyer's predilection for looking on the disorderly, accidental and confused result of historical development as a necessary order: the cramping grip of the dead hand has in this field notably restricted the free play of legal imagination. What we need is a law of manufacturing finance, a law of dealer finance, and a law of consumer finance,⁴ distinguishing between industrial and commercial consumers on the one hand and individual consumers on the other. Our categories should build on the underlying transactions and not on the tools that happened to be used in dealing with them. If that were to be done, there would be at least a fair chance of getting our law of short-term financing and chattel security to a point where the lender's protection would, at least grossly, be calculated according to his risk and not according to factors which, on any standard, are irrelevant.

We know that one way to take a city by storm is to parade seven times around its walls, meanwhile blowing loudly on the horn. In the hope that our jerry-built Jericho of credit transactions will prove to be flimsier than the original, we shall circle the fortifications but once; but that one circuit cannot be dispensed with, no matter how loudly the horn is blown.

We shall then, preliminarily, examine the various ways in which credit is extended in connection with the manufacture and distribution of goods and the devices by means of which the lenders protect themselves against the risks incurred.

The simplest situation is the open account shipment or delivery of goods where no security is taken. The seller trusts the buyer to pay him at some time after delivery, and is willing to give up control of the goods against a promise to pay.⁴ The promise to pay may be the simple

4. Under sales law the seller who voluntarily delivers goods to the buyer in advance of payment loses his rights against the goods and becomes a general creditor. *Frech v. Lewis*, 218 Pa. 141, 67 Atl. 45 (1907). For statutory provisions extending the seller's rights against the goods after delivery in special cases, see note 17 *infra*. Where the seller's consent to deliver the goods is induced by the buyer's fraud (e.g., false representations of solvency) the seller may rescind the sale and reclaim the goods from the buyer or his trustee in bankruptcy. *California Conserving Co. v. D'Avanzo*, 62 F.2d 528 (C.C.A. 2d 1933), 46 HARV. L. REV. 1344 (1933); see 2 WILLISTON, SALES § 636 *et seq.* (2d ed. 1924).

Delivery of goods against a check is not, under much case law, an extension of credit, so

contract promise inherent in the sales contract or it may be exacted in a negotiable form through the use of a trade acceptance, an accepted time draft, or less frequently the buyer's promissory note.⁵ The seller's position as against the buyer is substantially identical, no matter what the form of the buyer's promise; if the seller himself has ultimately to sue to collect, he may be infinitesimally advantaged where he sues on a negotiable instrument instead of a contract promise. From the buyer's point of view, his negotiable promise to pay, as against his contract promise, is potentially much more to his detriment than it is to the seller's advantage: if his note, draft or acceptance is used to secure a bank loan to the seller, the buyer stands to lose his contract defenses in the event that the seller's bank, after default, sues on the instrument. Since the bank will ordinarily sue the buyer only when its own customer, the seller, is insolvent, any remedy of the buyer back against the seller on an underlying defense is theoretical and bootless.

Where the seller resorts to outside financing, the buyer's negotiable promise may be somewhat more satisfactory to a bank or finance company as collateral for a loan to the seller than an assignment of the seller's accounts receivable.⁶ In both cases, since there is no tangible security, the bank's initial decision to make or deny the loan will be based more on its investigation of the seller's credit standing than on the premium of holding a negotiable rather than a non-negotiable claim against a buyer whose credit standing it may know little about. If the

that if the check is dishonored the seller may replevy even against a good faith purchaser from the bad-check buyer. This line of authority has been greatly criticized, see 1 WILLISTON, SALES § 346(a), and, at least as to the possibility of replevy from the good faith second purchaser, is expressly rejected in UNIFORM REVISED SALES ACT § 58.

5. A trade acceptance is a "draft drawn by the seller of goods upon the buyer for the purchase price of such goods, which draft has been 'accepted' by the buyer." 1 PATON, DIGEST OF LEGAL OPINIONS 41 (1940). The standard trade acceptance form contains the language: "The transaction which gives rise to this instrument is the purchase of goods by the acceptor from the drawer." *Id.* at 44. The mechanics of its use differ from those of the ordinary seller's time draft only in that the buyer's acceptance is procured before the acceptance is discounted.

6. That is, the interest rate on a discount of negotiable paper may be less than on an assignment of accounts receivable. SAULNIER AND JACOBY, ACCOUNTS RECEIVABLE FINANCING 86, 131 (1943) (cited by Jackson, J., in *Corn Exchange National Bank & Trust Co., et al. v. Klauder*, 318 U. S. 434, 440 (1943)) estimate that the effective rates in accounts receivable financing range from 9% to 20% per annum. Koessler, *Assignment of Accounts Receivable*, 33 CALIF. L. REV. 40, 58 (1945) writes: "The rates of the finance companies are said to be on the whole higher than those of the commercial banks. Moreover, the rates are progressively being lowered both by banks and finance companies, largely due to the low cost of money generally and, to some extent, to the natural operation of the forces of competition." A consideration, which is probably of slight importance today, is that commercial paper in negotiable form and meeting certain other requirements is eligible for rediscount with Federal Reserve Banks under § 13 of the Federal Reserve Act, 38 STAT. 263 (1913), 12 U.S.C. § 343 (1940), as implemented by Regulation A of the Board of Governors of the Federal Reserve System.

seller's collateral is in negotiable form, however, both the ratio of loan to collateral and the interest rate may be more favorable to the seller than when he assigns accounts receivable. Nevertheless, and despite the Supreme Court's jaundiced view of accounts receivable financing as shady business, the last desperate expedient to forestall a looming insolvency,⁷ it seems clear that a vast volume of legitimate and perfectly solvent business is carried on against such assignments.⁸

It is often said that open account shipments make up the great majority of sales transactions in this country. We may assume the statement to be true, if only because of its iteration, but there is still a sizable residue of cases where the lenders insist on protecting themselves by staking out a claim against the most immediately available security—the goods themselves.⁹

The basic form of chattel security is the pledge:¹⁰ delivery to the

7. *Corn Exchange National Bank & Trust Co., et. al. v. Klauder*, 318 U.S. 434, 439 (1943): "Receivables often are assigned only when credit in a similar amount is not available through other channels. Interest and other charges are high, and an assignment often is correctly understood as a symptom of financial distress." Accounts receivable may be assigned either on a notification (*i.e.*, notification to the debtor of the assignment) or a non-notification basis. The *Klauder* case involved loans made against assignments of accounts receivable within four months of bankruptcy on a non-notification basis; the assignee's proof of claim as a secured creditor in the bankruptcy was denied on the ground that the assignments, in view of applicable state law, were voidable preferences under § 60(a) of the Bankruptcy Act, 52 STAT. 840, 869, 870 (1938), 11 U.S.C. § 96(a) (1940). That the giving of security by the debtor against contemporaneous advances may nevertheless be a preference results from the Supreme Court's construction, definitively announced in the *Klauder* case, of the last sentence of § 60(a), as amended by the Chandler Act. See discussion of the point, 3 COLLIER, BANKRUPTCY §§ 60.39, 60.48 (14th ed. 1941 and Cum. Supp. 1946). For a discussion of the *Klauder* case and proposed drafts of a uniform Act concerning the assignment of accounts receivable, see Report of the Committee on Assignment of Accounts Receivable, HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 172 *et. seq.* (1944). A recent, comprehensive study of accounts receivable financing is found in N. Y. LEG. DOC. NO. 65(k) (Law Revision Commission, Communication and Study Relating to Assignments of Accounts Receivable, 1946).

8. See Koessler, *Assignment of Accounts Receivable*, 33 CALIF. L. REV. 40 (1945). According to Koessler "only a borrower whose solid conditions seem to warrant the prospect of a continuous credit relation, with a regularly revolving amount of receivables to be financed, is . . . considered . . . eligible for this kind of credit" by the commercial banks and finance houses engaged in accounts receivable financing, whether on a notification or non-notification basis. *Id.* at 59.

9. We restrict ourselves to a discussion of chattel security and exclude the real property mortgage as well as suretyship and intangible security. The exclusion is made not because the subjects excluded are less important than that of chattel security, but simply in order to narrow the field of discussion to practicable dimensions.

10. Pledge is basic as probably the first chattel security device in point of time. It is also basic in the sense that our chattel security devices usually depend for their validity on the extent to which their elements are deemed to conform to the elements of a pledge transaction. Thus recording is spoken of as an equivalent of possession from the point of view that a principal function of possession in pledge law was the notoriety which it presumably provided to creditors of the borrower; and in the law of bills of lading the possession of the

lender-pledgee of the chattel pledged for the duration of the loan period. Retention of the pledge by the borrower, or its redelivery to him during the loan period except—a modern graft on an ancient tree—for a temporary and limited purpose, invalidated the pledge.¹¹ The requirement of possession in the pledgee seriously restricted the usefulness of pledges in financing modern business transactions, in which it is essential that the borrower remain in possession of the goods, for processing, resale or use. The invention of the documentary pledge¹² has made the pledge a somewhat more useful financing device under certain circumstances—when the goods are in transit and in industries where the goods, such as wines and cheeses, by the nature of things have to remain a long time in storage, or where an expected quick turnover has not materialized. But the pledge, even documentary, greatly lacks flexibility, since the documents of title can be issued by the bailee only on deposit of the goods. An ingenious modern variant known as field warehousing has the warehouse come to the goods instead of the goods going to the warehouse. The borrower, usually a manufacturer, sets aside part of his plant under the exclusive control of an independent ware-

order bill is analogized to a pledgee's possession of goods from the point of view that a principal function of possession in pledge law was the lack of a practical power of use or disposition of the goods by the pledgor. These twin concepts of notoriety and control run through all our chattel security law.

11. On redelivery for a temporary and limited purpose, see *RESTATEMENT, SECURITY* § 11 (1941); *UNIFORM TRUST RECEIPTS ACT* § 3(3). Doctrinally the temporary and limited purpose should be restricted to cases where the pledgor's repossession is necessary to service the pledge—as, for example, the redelivery of a negotiable instrument for collection to a bank which has previously rediscounted it. On occasion, however, it has served too as a means of escaping the fundamental pledge idea of possession and control in the pledgees as in *Petition of Chattanooga Savings Bank*, 261 Fed. 116 (C.C.A. 6th 1919) (pledge of trucks, used in daytime by pledgor, returned at night to possession of agent for pledgee: *held*, pledge valid against pledgor's trustee in bankruptcy). And see *RESTATEMENT, SECURITY* § 11 (1941), illustration 3 to comment c. If the expansive approach to the temporary and limited purpose doctrine indicated by the foregoing citations were to become general, the availability of pledges in financing business transactions would be enormously increased. To date however the results are insufficiently predictable. Another exception to the rule of possession in the pledgee was worked by the idea of equitable pledge, according to which a pledgee out of possession could perfect his pledge within four months of bankruptcy without his taking of security being considered a voidable preference, since his taking possession by a convenient fiction related back to the time of the contract to pledge and there was no antecedent debt. The Chandler Act Amendment to the last sentence of § 60(a) of the Bankruptcy Act seems to have closed that avenue of escape. See generally, 2 *GLENN, FRAUDULENT CONVEYANCES AND PREFERENCES* c. 28 (1940). However even with all the exceptions that practice has grafted on theory, it is true to state that ". . . the pledge denotes possession and this means not only a change of dominion but notoriety as well." Doubtless possession, as Holmes, J. said, is "a matter of more or less. . . . But possession is a pragmatic factor always." *Id.* § 477.

12. That is the delivery to the pledgee of a negotiable document of title representing and controlling the goods—bill of lading, warehouse receipt—in lieu of the delivery of the goods themselves.

housing company, which then issues receipts against the goods set aside, the goods, as in the standard warehouse transaction, being released only against presentation of the receipts covering them. When the field warehousing is properly carried out, it is equivalent to a regular warehousing transaction, and the bother and expense of carting the goods from plant to warehouse and back is saved. Furthermore, as new inventory comes into the plant and is covered by warehouse receipts, the new receipts may be substituted as collateral, thus releasing from the pledge the same amount in value of old goods. By warehousing incoming raw materials finished goods can be shipped out free of the lender's security interest. In this way the thorny problem of fixing a security claim on a shifting stock of goods¹³ can be easily solved. The substitution of new collateral for old is of course available in any pledge, but, where inventory makes up the security, and must be kept on the plant premises, field warehousing provides the only practicable method of making the substitution. Thus the field warehousing idea is potentially a very useful one. Often enough however the field warehousing transaction is strictly a phony: the goods are not exclusively under the warehouseman's control or the "independent warehouseman" turns out to be a stock clerk on the borrower's payroll or, in a more involved arrangement, a subsidiary corporation. The prevalence of such abuses, and the difficulty of detecting them, may destroy the modified usefulness of the field warehousing idea even when it is honestly carried out.¹⁴

A peculiar common-law application of the pledge idea is found in the doctrine of seller's lien with its related extension, the seller's right of stoppage in transit.¹⁵ The thrust of our sales law has always been to throw the risks forward to the buyer at the earliest possible time.

13. See discussion pp. 533-5 *infra*.

14. On field warehousing generally see 2 GLENN, *op. cit. supra* note 11; Friedman, *Field Warehousing*, 42 COL. L. REV. 991 (1942). An interesting development along these lines is an act, more or less uniform, passed in many states, and often designated "The Storage of Grain on Farms Act." Generally the farmer sets aside a shed or sheds in which the grain is stored and which are sealed by a state employed sealer; negotiable warehouse receipts are issued and these are given to the money-lender. In field warehousing generally the loan transaction may be liquidated either by the borrower's paying the lender, or by delivery of the goods to the lender or his nominee; these statutes however seem to focus on the latter technique of liquidation specifying the duty of the farmer to deliver to the presenting holder (often at a particular market place). RESTATEMENT, SECURITY § 11 (1941) suggests the accumulation of agricultural surpluses in the 1920's as the reason for these statutes. Among the states having such statutes are Colorado, Illinois, Indiana, Iowa, Kentucky, Minnesota, Mississippi, Missouri, Montana, Nebraska, Ohio, Oklahoma and Oregon. In the buyer financed sales transaction, field warehousing or its equivalent is a useful security device to replace the inadequate forward contract of sale, see pp. 538-9 *infra*.

15. Codified in UNIFORM SALES ACT §§ 52-9. See generally 2 WILLISTON, SALES cc. 19, 20 (2d ed. 1924).

Thus in the case of a sale of identified goods in deliverable state, the buyer, by an all but conclusive presumption of law, becomes the "owner" of the goods when the contract is made and it is immaterial that payment, delivery or both are postponed.¹⁶ However, until payment and so long as he remains in possession,¹⁷ the seller may be regarded as having a security interest like that of a pledgee in the goods sold, but with the unique advantage of retaining any surplus after resale for his own account and not the buyer's. As the delivery of goods at a distance became a regular occurrence the seller's lien right was extended to the transit period while the goods were in the possession of a carrier. Before the development of the order bill of lading, the unpaid seller's right to stop the goods was his chief protection against the buyer's insolvency during the transit period. But it was an unsatisfactory weapon at best: the time of transit was uncertain, the chance of learning of the buyer's insolvency in time was equally uncertain, and the complexities of stoppage in transit law were many. A better system than the hit or miss one afforded by seller's lien and stoppage in transit was needed to control and finance the vast volume of goods in transit. It was developed on the analogy of the documentary pledge of warehouse receipts.

Under the new system the seller shipped on an order bill of lading, drew a negotiable draft on the buyer, attached the bill to the draft and handed them to his bank for discount or collection. If a demand draft was used, there was of course no credit extension from seller to buyer after delivery of goods to the buyer; the bank, where a discount was involved, loaned the seller the amount of the draft less discount during the time it took to obtain payment from the buyer through a correspondent of the discounting bank, securing itself meanwhile through its control of the goods under the bill of lading. When the buyer paid, the loan was liquidated and the security released. If a time draft was used the situation was the same until presentment of the draft; if the presenting bank handed over the bill of lading against the buyer's acceptance (the usual case), the situation reverted to the unsecured loan against promise to pay discussed above.¹⁸

16. UNIFORM SALES ACT § 19 (rule 1).

17. By special interest statutes in some states, particular classes of sellers are given a lien position *after* delivery of the goods without contracting therefor:

Maine: REV. STAT., c164, § 63 (1944): lien on farm products shipped to cannery, such goods as they are mingled with, and the cans themselves for 30 days after delivery to the cannery or until shipped by cannery.

La.: GEN. STAT. §§ 5071, 5073, 5075 (Dart, 1939): lien for sellers of cotton seed, moss, or sugar cane on goods while in manufacturer's possession.

Tenn.: ANN. CODE § 7980 (1934): lien for merchants, vendors or cotton brokers on cotton sold for 5 days after sale or delivery.

18. See pp. 519-20 *supra*. UNIFORM BILLS OF LADING ACT § 41 codifies the financing agency's right to deliver the bill of lading to the buyer against acceptance of any draft "by its terms

The relationship of the parties to this transaction—discount or collection by seller's bank of seller's draft on buyer with order bill attached—repays study because it has been so thoroughly and beautifully worked out in the cases. The bank has achieved the moneylender's ideal position. Assuming payment (or acceptance) in the usual course, the bank escapes any involvement in buyer-seller disputes;¹⁹ assuming dishonor of the draft the bank has its rights against the seller as drawer and indorser of the draft, usually reinforced by a charge-back provision.²⁰ Failing reimbursement from buyer or seller, it has iron-clad

payable on time, extending beyond three days after demand, presentation or sight." UNIFORM REVISED SALES ACT § 70 restates the same rule. Despite the statutory privilege, however, it is customary for banks handling time drafts for collection to stipulate for express authority from the seller-drawer before handing over the bill of lading against an acceptance. Thus a typical collection letter, set out in a text issued by the AMERICAN INSTITUTE OF BANKING, FUNDAMENTALS OF BANKING 288 (1946), directs the correspondent bank: to "deliver documents only against payment unless otherwise instructed."

19. UNIFORM BILLS OF LADING ACT § 37; *Bank of Italy v. Colla*, 118 Ohio St. 459, 161 N.E. 330 (1928), holding that bank which discounted seller's draft on buyer did not by its indorsement of the bill of lading warrant merchantability of the goods covered thereby. The wording of UNIFORM BILLS OF LADING ACT § 35 led at least the Oklahoma court into error on this point. *Fort Worth Elevator Co. v. State Guaranty Bank of Blackwell*, 93 Okla. 191, 220 Pac. 340 (1923), see 26 COL. L. REV. 63 (1926), and criticism of the decision by Professor Williston, 26 COL. L. REV. 330 (1926), and see further *Moses, Implied Warranties under the Uniform Bills of Lading Act*, 27 COL. L. REV. 251 (1927), with comment by Professor Williston, *id.* at 257. UNIFORM REVISED SALES ACT § 68 provides that a financing agency transferring a bill of lading as security for a draft to be collected, whether the draft is held merely for collection or following a discount, "warrants only his own good faith and authority." For a classic statement of the status of a bank indorsing a bill of lading as an incident to the collection of a draft, see *Guaranty Trust Co. v. Hannay*, [1918] 2 K.B. 623, 659, per Scrutton, L. J.

Furthermore, when the discounting or collecting bank collects the draft through a correspondent, the funds collected in the correspondent's hands are not subject to garnishment in aid of any claim against the seller by the buyer or other creditor. *Ranney-Davis Mercantile Co. v. Bumgarner*, 105 Kan. 474, 185 Pac. 287 (1919); *Blatz Brewing Co. v. Richardson & Richardson*, 245 Wisc. 567, 15 N.W.2d 819 (1944), 29 MARQ. L. REV. 66 (1945). This holding seems to follow, whether the bank holds the draft merely for collection or following a discount, provided only it has credited the seller's account, and despite the presence of the customary charge-back provisions or local legislation such as § 2 of the BANK COLLECTION CODE. The general rule in the bank collection cases is that where a bank has credited the amount of a check or draft to a customer's account, whether or not the credit, by deposit slip stipulation or statute, is revocable, it becomes a "purchaser" of the draft and thereafter collects its own money. See *Burton v. United States*, 196 U.S. 283 (1905); *City of Douglas v. Federal Reserve Bank of Dallas*, 271 U.S. 489 (1926); *Steffen, The Check Collection Muddle*, 10 TULANE L. REV. 537 (1936).

20. A typical charge-back provision reads in part: "The acceptance for deposit or collection of all items except cash is conditional upon their subsequent payment. . . . Until final payment is received in money or in solvent bank obligations, items may be charged back or credit theretofore given may be cancelled." See the standard form of provision recommended by the American Banker's Association, set out at 2 PATON DIGEST OF LEGAL OPINIONS, 1366 (1942). BANK COLLECTION CODE § 2, in the jurisdictions where it is in effect, reaches approximately the same result as a charge-back provision.

control over the goods themselves which, on default by both parties to the sales transaction, it may sell without any particular formality. The pledge of the goods is perfected by delivery of the bill of lading indorsed; provided only the seller had even a voidable title to the goods at the outset of the transaction, no third party can take the goods from the bank.²¹ The seller takes out his money on delivery of the goods to the carrier and is in the advantageous position of being able to make the buyer pay first and adjust any disputes later. The buyer, although he is in the unfavorable position of having to pay blind, benefits from the rule of "strict compliance"²² rigorously applied in documentary contracts, and furthermore, by getting possession of the bill of lading in advance of the arrival of the goods, may resell immediately—a most useful feature if the buyer is a dealer.²³

The mechanics of the comparable transaction whereby the buyer's bank, instead of the seller's, extends credit to the seller while the goods are in shipment have been worked out almost as precisely. The pattern is more involved, the documents more numerous, but the result achieved is substantially the same as the simple discount by seller's bank of seller's draft with order bill attached. Where seller's bank finances, there are two sets of agreements: the underlying sales contract and the discount agreement between seller and the financing bank. Where buyer's bank finances, a third set is added: the reimbursement contract between buyer and financing bank. The discount agreement between seller and bank is now set out in a letter of credit, or, less frequently, in a guaranty of payment of drafts drawn on the buyer. Where the buyer reimburses his bank before or at the time of the bank's payment of the seller's draft drawn under the letter of credit, the situation is identical with that where the seller's bank finances on the seller's demand draft drawn on the buyer: payment liquidates the transaction (so far as the financing bank is concerned) and terminates the loan period. Where, however, reimbursement by the buyer is to be deferred, the form of the transaction following presentment and payment of the draft will in all probability be significantly different from that observed where seller's bank has discounted a time draft on the buyer. As we have seen, if the bank delivers the bill of lading to the buyer against his acceptance of the draft, the loan, which was secured up to that point,

21. UNIFORM SALES ACT § 33; UNIFORM BILLS OF LADING ACT § 32. UNIFORM REVISED SALES ACT § 61 is designed to state the protection accorded an indorsee of negotiable documents of title more explicitly than did the earlier uniform acts.

22. That is to say, the slightest deviation on the seller's part in assembling the documents required will justify the buyer (or the buyer's bank) in dishonoring the draft. "There is no room in commercial contracts for the doctrine of substantial performance." L. Hand, J. in *Mitsubishi Goshi Kaisha v. J. Aron & Co.*, 16 F.2d 185, 186 (C.C.A. 2d 1926). The cases being legion, citation would be idle.

23. See Professor Llewellyn's comments on the general situation in his *CASES AND MATERIALS ON THE LAW OF SALES* 77 ff., 758 ff. (1930).

reverts to an unsecured status, the bank holding for the balance of the loan period (*i.e.*, until the maturity of the draft) a negotiable instrument on which the buyer is primarily and the seller secondarily liable. When the buyer's bank finances under a letter of credit, with reimbursement deferred, presumably until the buyer has in his turn resold the goods, the buyer's bank is in a position to, and usually will, stipulate for a continued hold over the goods until reimbursement—typically by releasing the goods to the buyer under a trust receipt. There is no doctrinal reason why the seller's bank, having discounted a time draft on the buyer, could not secure itself after handing over the bill of lading, through buyer's trust receipt or otherwise, until payment of the draft. This is not, however, regularly done: probably because interstate (or foreign) shipments are usually involved, control of the goods after delivery would require the bank to operate through correspondents in jurisdictions with which neither the bank nor its counsel might be familiar, and it is no doubt simpler to let the goods go and to exact any desired collateral directly from the seller, who is, after all, the bank's customer.

Our law has reached an admirable state of precision with respect to the financing and control of goods during shipment. The mechanics of the operation are simple and well understood, the cost minimal, and disputes which cannot easily be settled are rare. The range of possible trouble spots in the seller's bank case had been thoroughly explored by the time the Uniform Bills of Lading Act was drafted.²⁴ The codification accurately reflected the commercial practices of the time, and, since those practices have remained static, litigation has been infrequent. The buyer's bank-letter of credit complex was worked out in a flurry of cases during the 1920's.²⁵ There, after initial hesitation and difficulty, the formally complicated interrelationships of the parties were satisfactorily determined and litigation notably decreased.

24. The draft was approved and recommended by the National Conference of Commissioners on Uniform State Laws in 1909. It has been enacted in 31 states, the District of Columbia and Alaska. The Federal Bills of Lading Act, 39 STAT. 538 (1916), 49 U.S.C. § 81 *et seq.* (1940), applies to all bills of lading issued for shipments interstate or originating in this country for a destination in a foreign country and is, except for a few minor deviations, identical in form and substance with the Uniform Act. Ocean bills of lading issued in connection with the carriage of goods by sea to or from ports of the United States in foreign trade are further subject to the provisions of the Carriage of Goods by Sea Act, 49 STAT. 1207 (1936), 46 U.S.C. § 1300 *et seq.* (1940), which was the United States ratification of an international convention adopted at Brussels in 1923. The Carriage of Goods by Sea Act regulates the distribution of liability between ocean carrier and the owner of the goods shipped and does not affect the degree of control over the goods accorded to the holder of an order bill of lading. The Harter Act, 27 STAT. 445 (1893), 46 U.S.C. §§ 190-5 (1940), continues to have a limited applicability to the liability of water carriers in situations not covered by the Carriage of Goods by Sea Act.

25. The cases are collected in FINKELSTEIN, *LEGAL ASPECTS OF COMMERCIAL LETTERS OF CREDIT* (1930).

Although uncoded, this branch of the law became sufficiently precise, in its case law development, from, say, 1930, to allow free use of the letter of credit without having to anticipate undue hazards of litigation.

The clarity of the law on goods in transit may be attributed to the relative simplicity of the problems involved. Once it had been seen that a freight car, although it had wheels, was in other respects like a warehouse, the elements of solution were at hand. As soon as the negotiable bill of lading had been worked out,²⁶ it was appropriate to write Q. E. D. Probably the order bill developed initially as a control rather than as a financing device, to replace the haphazard protection of the seller against the buyer's insolvency afforded by the seller's common-law right of stoppage in transit. Its effectiveness as a device allowing control of the goods during transit automatically solved the financing problem as well, since it made possible a perfect documentary pledge.

Trouble starts for the creditor who would be secured when the goods must come out of the warehouse, fixed or on wheels, and be put to use before they have been paid for. Historically the problem seems to have become acute in this country as an incident of the vast industrial expansion occasioned by and following after the Civil War, and made possible by the laying of a transcontinental rail network. Our law reports, theretofore relatively innocent of the problem of chattel security, begin to bristle with the bright devices of lawyers breaking new ground.²⁷ Here, however, there was no unanimity of agreement; many tentative suggestions were put forth, some of which have survived,

26. The sharp distinction between "straight" and "order" bills with which we are familiar was surprisingly late in developing. "The cases down to 1890 rarely mention whether a bill of lading is ocean or railroad, order or straight. It is assumed, simply, that bill of lading is bill of lading, and assumed that all bills of lading are of one single well-known kind—which is taken to be whichever kind the speaker happens to know." LLEWELLYN *op. cit. supra* note 23, at 80. And *cf.* the hesitation of the Supreme Court in 1879 as to the degree to which negotiable bills were really negotiable: "It cannot be, therefore, that the statute [*i.e.*, early state statutes] which made them negotiable by indorsement and delivery, or negotiable *in the same manner* as bills of exchange and promissory notes are negotiable, intended to change totally their character, put them *in all respects* on the footing of instruments which are the representatives of money, and charge the negotiation of them with all the consequences which usually attend or follow the negotiation of bills and notes." *Shaw v. Railroad Co.*, 101 U.S. 557, 565 (1879).

27. It is true that by 1850 a chattel mortgage so designated by parties or court had been attempted in each of the fact situations with which we shall hereafter deal. See *Wagner v. Watts*, 28 Fed. Cas. 1336, No. 17,040 (C.C.D.C. 1819) (chattel mortgage to independent financier on book-dealer's stock in trade); *Moody v. Wright*, 13 Metc. 17 (Mass. 1847) (purchase money chattel mortgage from tannery to seller of hides); *Divver v. McLaughlin*, 2 Wend. 596 (N.Y. 1829) (chattel mortgage on grocer's stock in trade to liquor supplier); *Robinson & Caldwell v. Mauldin, Montague & Co.*, 11 Ala. 977 (1847) (deed of trust on growing cotton, debt to be liquidated by delivery of cotton or payment); see generally CENTURY DIGEST, under the heading of Chattel Mortgages. The relative unimportance of the device is, however, illustrated by the scanty treatment given it by Kent and Story.

others of which have disappeared without trace. The triumphant solution of the goods-in-transit problem, and the subsequent mill-pond peace of that branch of the law find no analogies in the turbulent history of the financing of goods held for processing, resale and use.

It is a lawyer's habit of mind, when faced with a novel situation, to attempt to solve it by adapting an already known instrument which has served well in a situation as nearly as possible analogous to the one confronting him. In working out the problem of financing the sale of goods held by manufacturers and distributors, the nearest analogue was the venerable chattel mortgage, sired by the real property mortgage out of necessity and still bearing in its old age the unmistakable marks of its paternity.²⁸

28. The early history of the chattel mortgage, as distinguished from the real property mortgage, is obscure, filled with doubt, and has been neglected by the legal historians. That the concept of chattel property as collateral security remaining in the borrower's possession (*hypothec*) has almost as ancient a lineage as the concept of the same property going into the lender's possession (pledge), see Wigmore, *The Pledge-Idea: A Study in Comparative Legal Ideals*, 10 HARV. L. REV. 321, 389 (1896), 11 HARV. L. REV. 18 (1897). Of course if (before the era of recording acts) the only kind of chattel mortgage valid against third parties was one with the mortgagee in possession, the distinction between chattel mortgage and pledge was metaphysical at best. In the sixteenth century the Statute of Fraudulent Conveyances, 13 ELIZ., c. 5, made the retention of possession by vendor, grantor or mortgagor subject to attack by creditors, and the English Bankruptcy Acts since 1623, 21 JAC. I, c. 19, § 11, provide in substance that if bankrupts "by the consent and permission of the true owner and proprietary have in their possession, order and disposition any goods and chattels whereof they shall be reputed owners," such goods shall pass under the commission in bankruptcy. A distinction was taken between such retention of possession as was fraudulent in point of law and such as founded merely a rebuttable presumption of fraud, see 1 WILLISTON, SALES § 352 (2d ed. 1924), but nevertheless, until the coming of the recording acts, the chattel mortgage with mortgagor in possession must have been a queasy device at best. Professor Glenn argues, with a wealth of authority, that the chattel mortgage is nothing except as it is validated by a recording act (as it is today in all 48 states): ". . . we can never avoid trouble so long as we try to think of the chattel mortgage as though it were part of our concepts of property and possession, so far as those words relate to personal property. It is harder to work this form of security into those grooves than it is to outfit a pledge with clothing cut to the measure of the bailment. . . . We should say . . . that a chattel mortgage is inconceivable unless a statute says otherwise; and hence the life and well being of this security device depend upon prompt and strict conformity with the recording acts without which, indeed, it would be nothing." Glenn, *The Chattel Mortgage as a Statutory Security*, 25 VA. L. REV. 316, 338-9 (1939). Nevertheless, admitting Professor Glenn's thesis that the chattel mortgage as we know it today is for all practical purposes a 19th century invention, it remains true that it was new wine in old bottles. The mere fact that it was called mortgage, that it was in form mortgage, linked it up with a past from which it may, historically, have had no direct filiation. The important thing was that, at least in the minds of the lawyers who drafted the instruments, chattel mortgage was essentially mortgage, and that meant tied in with the equitable tradition of borrower's rights—a conception (or misconception) that had its results, at least in matters of form. We believe it to be substantially, even if not formally, true to relate the eccentricities of the chattel mortgage to the late mediaeval background in which in any case our real property mortgage developed. Whether the relation is formally true, no one really knows.

The chattel mortgage, like the real property mortgage, is in form a conveyance from mortgagor to mortgagee of title to the property mortgaged, subject to defeasance on payment by the mortgagor of the mortgage debt. Until recently legal discussion on the nature of mortgage has centered on the question whether the mortgagee receives title to, or "merely" a lien on, the property mortgaged. Today although some jurisdictions nominally espouse the "title" theory and others—an increasing number—the "lien" theory, there is little difference in the result arrived at. The mortgagee has first a money claim, and, on default in payment, the right to satisfy his debt out of the goods, returning any surplus to the mortgagor or claiming for any deficiency. Substantially there is little difference between the status of mortgagee and pledgee in possession after default. Procedurally the mortgagee is not quite so well off as the pledgee, although, as we shall see, many of the limitations imposed on the mortgagee can be contracted out of.

In any situation where a money claim is secured, it is not contemplated that there will in fact be a resort to the security. If the transaction goes off as scheduled, the debtor will pay and the security will be released. Presumably in times of prosperity the great majority of security transactions arrive at this contemplated solution. It is typically when times are bad that the security holder must look to his security; thus he will have to realize on it at the worst possible time, and, unless he has insisted on a considerable excess of collateral over loan, will likely end up with a deficiency claim.

Such considerations suggest inquiry as to the relative value to the security holder of his money claim and his possessory right to the security. Here a distinction must be taken between the financing of consumer sales and the financing of intermediate sales between professionals. If the individual, purchaser of a radio, a washing machine or an automobile, is unable to meet his payments, repossession of the chattel sold is apt to be the only remedy which will be of practical use to the creditor. In the average case the chances of collecting the debt in any other form are slight, the exemption statutes will block the creditor's attempt to collect on the debtor's other assets, and the type of chattel whose sale to the consumer is financed will likely be resalable secondhand. And, with the exception of the automobile, which is often enough fraudulently disposed of by the purchaser, inability to pay is the only serious financing risk. Contrast the consumer sale case with the financing of manufacturing inventory. If the enterprise becomes insolvent, the financier must compete with a group of other creditors, secured and unsecured, as well as statutory lien claimants for wages, taxes and so on. Even if the individual security-holder could high-handedly seize the property to which his lien attaches, cart it off and sell it, he would not be much advantaged: perhaps only a fraction of the inventory is in finished form, the work in process may be salable

only as scrap, and in any case the disposition calls for contacts in the trade which the financier may well not have. Furthermore, the enterprise as a whole has assets, fixed and liquid, which can be tapped to satisfy creditor's claims—which may well not be the case with the individual. Thus the right to seize and foreclose is only a theoretical strategy; what is needed is the orderly reorganization or winding up of the enterprise in the hands of a creditors' representative. Eventually the creditor will be paid off in money, and the importance of his initial taking of security is not that he will actually realize on it, but that, being secured, he will rank higher in the distribution than his unsecured competitors. The foregoing is doubtless true for the majority of small and middle-sized enterprises; it becomes indisputable in the case of the giant corporation or railroad, which cannot conceivably even be liquidated but can only be reorganized. Financing of a distributor's stock has elements of both the situations already noted. Since the goods are held for resale in finished form, the idea of taking and selling them is somewhat more sensible than in the case of a hodge-podge of manufacturing inventory. But, as with the manufacturing enterprise, a group of other creditors and lien claimants will be involved and an orderly distribution will probably net more than individual self-help. Another factor, however, magnifies the usefulness of a right in the creditor to quick possession of the security as against the borrower-distributor: a distributor, because of the kind of business he is in, is able to dispose of his creditor's security free of the creditor's lien—since the financing of a dealer's stock necessarily implies a power in the dealer to sell to buyers in the ordinary course of trade, who will take free of the financier's interest. Thus, quick possessory rights over the security, after and if possible before default, has a peculiar virtue in this situation.

We conclude then that the actual value of possessory rights to the security holder varies considerably according to the type of transaction he is financing, although our law, unitary here as elsewhere, declines to take distinctions. We may now, following our digression, rejoin the chattel mortgage.

It would have been an astonishing tour de force if a legal instrument, having its roots in a society where land and cattle were the principal forms of wealth and where the velocity of property transfer was almost nil, had been successfully adapted for use in a society where the forms of wealth have become highly diversified and at the point in that society where the velocity of property transfer is greatest. The mortgage comes to us from a society where borrowing money was an abnormal thing to do—the last expedient of a foundering debtor, who borrowed, not as a convenient way of acquiring new property but in the hope of saving what he already had. The long and dramatic rise in the price level which became marked after 1500 fell with crushing weight on the tradi-

tional elite, the land-owning class, but nevertheless the owners of land even while they were coming to be the debtors of the rising mercantile class retained, long after their eclipse had become manifest, their power over the state and a commanding voice in the writing of legislation and the handing down of judicial decisions. Finally, the money-lender, during the period when our law of mortgage took shape, was not the respectable personage which our banker today likes to think he is. The Church brought its immense power to bear against the practice of lending money for interest and forbade such traffic to its communicants. The money-lender, the usurer, was a rascal against whose sharp practices God-fearing men were entitled to protection.²⁹

Such a social background helps to explain the restrictions which were placed upon the lender of money in his dealings with his borrower in a legal system which was not, overall, too solicitous for the hard-pressed. The restrictions were of two kinds: there was first the complex of ideas which built on the borrower's beneficial ownership of the goods mortgaged, the equity of redemption and the requirement that the mortgagee realize on the security only through judicial action; secondly, there was the bias in favor of remitting all creditors to an unsecured race of diligence save where possession of the security was actually taken.

The first obstacle, the equity of redemption, was easily hurdled: a technique was worked out for foreclosing the mortgagor's equity by non-judicial proceedings through clauses giving the mortgagee a power of sale after valid possession taken³⁰ without the necessity of resorting

29. Everything is relative, and violent and sudden social change is not the unhappy monopoly of our own time. That the 16th century knew a great deal about credit, security, the lending of money at interest, and concomitant abuses, see the fascinating introduction by Tawney to his 1925 edition of WILSON, *A DISCOURSE UPON USURY* (1572). Familiarity with credit transactions at that time does not mean that anti-money-lender attitudes developed from a premercantile culture would have undergone prompt change. Indeed it is likely that such attitudes, having found expression in statutory condemnation of the money-lender in the 17th century, see note 28 *supra*, lay dormant but not forgotten until the Industrial Revolution evoked a new need for security devices.

30. The rule as to possessory rights was developed as follows: in the beginning, absent a contrary agreement, the mortgagee had full possessory rights before or after condition broken. During the 19th century states by statute began to switch this rule around, giving the mortgagor the presumptive property rights; but it was still a matter of contract, and, likely, the money lender, to the extent that he was able to insist on security at all, was able to dictate the terms. See 2 JONES, *CHATTEL MORTGAGES AND CONDITIONAL SALES* §§ 426-53 (Bowers ed. 1933); STURGES, *CASES ON CREDIT TRANSACTIONS* 496-8 (3d ed. 1947). Generally speaking, the mortgagee today has possessory rights upon condition broken; a rule or valid contract clause giving him possessory rights before condition broken has the effect of an "insecurity" clause, that is, a clause accruing certain powers and rights to a party who has extended credit if he gets unfavorable credit information about his borrower before any actual default has occurred.

to the courts.³¹ The mortgagee was even allowed to contract for the power to buy in the security at private sale, which in practical effect was apt to give him his security, and a whopping deficiency judgment into the bargain. But this type of deal found short shrift in court, if the borrower was able to litigate.³²

The second obstacle, the early 19th century bias in favor of the unsecured creditor, amounted to a road-block. That bias had an institutional foundation, since, in the post-revolutionary American economy, bank credit was customarily extended on one-name paper without security; most sales were cash transactions or seller-financed open account shipments. In such a setting the chattel mortgage was an out-of-due course oddity uneasily tolerated; where most creditors were unsecured, the occasional security-holder could be sure of running into trouble, particularly where his lien was secret and the debtor remained in control of the security. Recording statutes took care of the secrecy argument, but the propositions deduced from the control notion eventually made the mortgage an unsatisfactory device except in the financing of sales to consumers.

The chattel mortgage, transposed into an industrialized society, still works well enough when it is used in the context it was originally designed for: that is, a loan against tangible security, consisting of goods that have come to rest in the permanent possession of the borrower. It consistently comes to grief when for goods at rest as security there are substituted goods in motion.

A manufacturer wishes to arrange short-term financing against his current inventory of raw materials, work-in-process, and finished goods awaiting shipment. As the finished goods move out, their place is taken by the work-in-process, the raw materials move onto the production line, and new raw materials replace them. In this situation it is not enough for the manufacturer to borrow, say, ten thousand dollars for six months. He has to establish a line of credit good indefinitely, or so long as he stays in business, and the proceeds of the sale of finished goods must go, at least in part, not to satisfy the mortgage but to purchase new raw materials. The mortgage, to be workable in such a

31. 2 JONES, *op. cit. supra*, note 30, §§ 789 ff.

N.B. that "mortgage with a power of sale" may refer to the power of the mortgagee to sell the security upon possession taken, or to the power of the mortgagor to sell the goods which constitute the security during the regular operation of his business within the loan period.

32. That is through judicial control of the "fairness" of the resale price, which the courts have been particularly willing to exercise where the mortgagee shows up as purchaser at the sale. See 2 JONES, *op. cit. supra* note 30, § 791 and cases there cited. In English mortgage law the mortgagee who purchases at public or private sale, loses his right to a deficiency judgment, thus outlawing a prevalent American abuse. Turner, *An English View of Mortgage Deficiency Judgments*, 21 VA. L. REV. 601 (1935).

situation, must contain clauses giving the manufacturer-mortgagor power to sell the mortgaged goods,³³ and subjecting all after-acquired property to the mortgage lien. Such clauses were drafted and have fared indifferently well at the hands of the courts.³⁴ But a chattel mortgage with mortgagor in possession plus power of sale clause plus after-acquired property clause was about the largest camel which could be swallowed.

Line of credit financing involved two separate but related concepts, both difficult for common-law courts to accept. The idea that a lien is a right attached to a specific thing is rooted deep. The after-acquired property clause, which provides that the mortgage lien shall attach not only to described property but also to other property of the same type as it shall come into inventory already seems doubtful, but the saving feature is that there is always a residue of property, fixed and stable, to support the lien, which is thought of as being merely reinforced as the new stock comes in.³⁵ A clause allowing the mortgagor to sell the mortgaged goods free of the lien is acceptable: as the goods are sold the lien vanishes since there is no longer anything to support it. Combine the two clauses in one instrument and you are immediately in a new dimension: now there is not even a residue of stable property to help out the metaphysics of lien theory. The mortgage is now sought to be shored up on a perpetually shifting stock. The idea of shifting stock is one of the difficult concepts. Still there is a way out: if the mortgagor, as he sells under the power, is required to account to the mortgagee for the proceeds of sale,³⁶ the mortgage will be satisfied before the goods originally supporting the lien have been disposed of.³⁷ In that case we

33. Whether or not the mortgage instrument itself contains a power of sale clause, at least the parties must by the commercial necessities of the manufacturer—borrower's position contemplate that the mortgagor will sell the mortgaged goods. In a jurisdiction holding that such a power of sale vitiates the mortgage, it is of no significance whether the power is drafted into the mortgage instrument or is collateral or implied. See Cohen and Gerber, *Mortgages of Merchandise*, 39 COL. L. REV. 1338, 1348-50 (1939) and cases cited.

34. See 2 GLENN, *op. cit. supra* note 11, cc. 33, 34.

35. But there was dissent as to the validity of even the after-acquired property clause. See generally Cohen and Gerber, *The After-Acquired Property Clause*, 87 U. OF PA. L. REV. 635 (1939).

36. "Account" is a simple word, but the mechanics may become complicated. The agreement for reimbursement of the mortgagee may provide for installment payments of principal or interest, or may not; the times provided for payment may or may not designedly or fortuitously coincide with the times at which the mortgagor will have completed his sales; the amounts to be paid at particular times may be specified absolutely or in terms of a specified percentage of gross or net receipts; where specified in terms of absolute amounts, these may in fact have been calculated as a rough percentage of anticipated gross or net receipts. In any case no definition applied by any court stressing duty or lack of duty to account as a factor of importance in validating or invalidating a mortgage makes consistent sense as to all types of likely or possible fact situations in terms of accomplishing the court's stated objectives. See cases collected in Cohen and Gerber, *supra* note 33.

37. Assuming, that is, that the value of the goods on hand when the mortgage was

have not actually had to deal with a floating lien: it was in the offing but was avoided. On the other hand, by applying the proceeds of sale to the mortgage we have given up the flexibility and advantage of a revolving fund, a line of credit. What is needed is an arrangement which will leave the proceeds available for reinvestment in new inventory: *i.e.*, no duty in mortgagor to account. And now in truth the lien floats. And the stock shifts.

But this was the sticking point: under the pattern of thought induced by the word "mortgage" no such arrangement was possible. A mortgagee willing to play so fast and loose with his security deserved to lose it—and frequently did.³⁸ Indeed, so severe was the judicial condemnation, that he lost it without regard to his having complied with the local recording laws and even despite the fact that he had actually taken possession of the current inventory in advance of the attaching creditor or the mortgagor's trustee in bankruptcy—in those cases where the mortgagee was careful or lucky enough to make the seizure.³⁹

In the financing of growing crops problems not unlike those of financing the manufacture of goods are encountered. In this situation also it is necessary to liquidate the loan out of the proceeds of the sale of the security, which immediately sets up the same legal hurdles of "power of sale," "duty to account," and "after-acquired property." Although there is a regular production cycle, to which the length of the loan period can be geared, as in the case of a seasonal manufacturing enterprise, a loan period beyond a particular crop production period may, as in the manufacturing situation, be desirable. There are special agricultural wrinkles: if the mortgage covers, say, feed and livestock,

executed was at least equal to the mortgage loan. Since it is customary banking practice to insist on an excess of collateral over loan, we may rest on the assumption and dismiss the contrary case as a transaction too unlikely to be of commercial importance.

38. The leading case is *Zartman v. First Nat. Bank of Waterloo*, 189 N.Y. 267, 82 N.E. 127 (1907). An exceptional statute validating the lien on shifting stock with at least some relaxation of the duty to account is Wis. STAT., c. 241, § 14 (1945). The lien is good as to all property described (although it is not clear from the language how complete and how fast remittance of the proceeds to the mortgagee must be) if the mortgagee files at least every 4 months a statement of the aggregate amount of sales made from the original stock, the amount applied on the mortgage debt, and the total valuation of stock added. In general, however, the statutes are silent and the invalidation of the floating charge sought to be imposed on a shifting manufacturing inventory has been accomplished by case law. The UNIFORM CHATTEL MORTGAGE ACT (adopted only in Indiana) took an advanced stand, providing in § 25(4) that, save as against purchasers from the mortgagor in the ordinary course of trade, "a mortgage shall not be invalid as against any person by reason of the consent of the mortgagee to sale or other disposition of the goods by the mortgagor, or by reason of the absence of duty in the mortgagor to account for the proceeds of such disposition or to replace the goods disposed of pursuant thereto."

39. In the *Zartman* case, note 38, *supra* the mortgagee took possession one day after default in the payment of interest and three days before the commencement of bankruptcy proceedings against the mortgagor.

and the feed has to be fed to the livestock before marketing, what does that do to the mortgage? And finally, the after-acquired property concept takes on new shape; it no longer operates in the context of replacements of security, but rather in that of the "true nature" of unharvested or unplanted crops; if they are not "property" they cannot be "mortgaged", since a man clearly cannot "mortgage" what he "hath" not.⁴⁰

In general the crop mortgage and the manufacturing mortgage, to the extent that they involved similar problems, called forth similar judicial reaction.⁴¹ That is to say, where there was no duty in the mortgagor to account for the proceeds, invalidity often followed. But the problem of feeding part of your security to another part was solved favorably to the mortgagee, and worries about the property nature of crops were put to rest with the doctrines of potential possession and equitable mortgage.⁴² Statutes were passed in most states validating mortgages on crops "grown or growing, planted or to be planted", but usually stipulating that the harvesting or planting had to be within a stated time from the execution of the mortgage, sometimes varying the time for particular crops.⁴³ The statutes thus implicitly voided the mortgage with a loan period extending beyond a single crop season.

In connection with the federal government's extensive farm credit program in the 1930's, over half the states passed new crop mortgage acts. The federal statutes setting up the crop loan program⁴⁴ provided that loans should be made and collected on such terms as the Governor of the Farm Credit Administration should prescribe, that as security there should be a first lien or agreement to give a first lien on the crops or livestock for the year of the loan, and the moneys loaned were impressed with a trust until used by the borrower for the purpose lent.

The Enabling Acts of the state legislatures were more or less uniform.⁴⁵ For our purposes the most interesting point on which the stat-

40. Not that such metaphysical speculation has not been engaged in with respect to non-agricultural finance. The famous case of *Holroyd v. Marshall*, 10 H.L. Cas. 191, 11 Eng. Rep. 999 (1862) involved a manufacturer mortgaging what he had not, *i.e.*, machinery which might be acquired to replace machinery covered by the mortgage.

41. For the cases, see 2 GLENN, *op. cit. supra* note 11, c. 34.

42. The doctrine of potential possession implies that the grantor, vendor, mortgagor has a present interest in the property—*i.e.*, land, livestock—from which the increase is to come. Thus in *Grantham v. Hawley*, Hob. 132 (1616), from which the doctrine stems, the court's reasoning was that "he that hath [the land] may grant all fruits that may arise upon it after." On the equitable mortgage see Stone, *The "Equitable Mortgage" in New York*, 20 COL. L. REV. 519 (1920); VOLD, SALES §§ 42-4 (1931).

43. See, *e.g.*, S. D. CODE § 39.0406 (1939); WASH. REV. STAT. § 3779 (REMINGTON, 1932).

44. 47 STAT. 795 (1933), 48 STAT. 257 (1933), 49 STAT. 28 (1935), as amended, 50 STAT. 5 (1937), 12 U.S.C.App. §§ 1020(i)-1020(o) (Supp. 1945).

45. Typical of the more detailed statutes are: IND. STAT. ANN., tit. 51, §§ 501-6 (Burns, Supp. 1945); N. J. STAT. ANN., tit. 4, art. 18, §§ 1-24 (1939).

utes split is whether the special lien position of the mortgagee should be available for only one crop production period, or should be available for financing extending beyond a single crop. States adopting statutes providing for the former generally require the mortgage to impose a duty to apply the proceeds of sale to the debt, while those adopting the latter view permit the proceeds to be used for the purchase of new security to be subjected to the mortgage lien.⁴⁶

In the administration of the Federal crop loan acts, there were some misgivings as to how state law would affect the government's security. Thus a bulletin of the Regional Agricultural Credit Corporation provides that all proceeds of sale of the goods shall be applied on the loan, and the borrower permitted to apply for an additional loan under the additional advance clause contained in the mortgage.⁴⁷

In financing the distribution of goods the difficulties with the chattel mortgage are substantially the same as those noted in connection with the financing of their production. The manufacturer's position may frequently be more stable than the distributor's, so that, even though the security he can offer (so far as inventory is concerned) is tenuous and even illusory, he may nevertheless be the more acceptable credit risk. No doubt, at least in certain industries, it would be possible, although inconvenient and cumbersome, to meet the fatal objection to the floating manufacturing mortgage by arranging for a series of short term mortgages calculated on the length of the manufacturing process. But with the distributor, fluctuations in turnover are often such that even that expedient would be unavailable: the regular rhythm of the production run is fatally lacking. At any rate mortgages on merchandise in the hands of distributors have met with even less success than mortgages on manufacturing inventory.⁴⁸

Thus far we have considered the situation of a manufacturer, farmer or distributor obtaining mortgage financing on his inventory, crops or stock, on hand and to be grown or acquired, from a third party who enters into the transaction only as a money-lender.⁴⁹ Often, however,

46. The statutes further split on whether the benefits to a mortgagee are confined to government finance agencies, or are available to all money-lenders. In at least one state, a statute drafted to include only government agency mortgagees has been amended to include any financing institution. N.J. STAT. ANN., tit. 4, § 18-2 (Supp. 1947). But the benefits of the acts are not extended to financing buyers of farm products.

47. 6 CODE FED. REGS. § 93.1 (1938).

48. See an exhaustive discussion in Cohen and Gerber, *Mortgages on Merchandise*, 39 COL. L. REV. 1338 (1939); Cohen and Gerber, *The After-Acquired Property Clause*, 87 U. OF PA. L. REV. 635 (1939).

A hazard for the dealer merchandise mortgage not faced by the manufacturer mortgage is the Bulk Mortgage Act, see e.g., Mich. Ann. Stat. § 19.371 ff. (1937), which invalidates the mortgage unless prior to its execution notice is given to all creditors of the mortgagor. Bulk Sales Acts however are usually held not to apply to mortgages. *Talty v. Schoenholz*, 323 Ill. 232, 154 N.E. 139 (1926); Notes, 49 A.L.R. 1487 (1934); 44 YALE L. J. 348 (1934).

49. The borrowing of money by a consumer from a financing agency against goods

the financing is done in the first instance by one of the parties to the sales transaction.

We have discussed the sale on unsecured credit against the buyer's promise to pay, negotiable or nonnegotiable. If the seller wishes to secure his position, a purchase-money chattel mortgage is a conceivable device. If what the buyer needs is a line of credit on shifting stock, the mortgage is generally⁵⁰ no better in the hands of the seller than it would be in the hands of the money-lending bank or finance company. The seller is, however, better able than the bank to police the details of covering an individual shipment with a mortgage relating to that shipment alone, to be retired by the proceeds of resale before the next shipment is made, and so on in an infinite series. If the credit involved is truly short term, 30 or 60 days, so complicated an operation may resemble a mosquito-hunt with large cannons, but if enough money is involved it may be worth the cost and trouble—as indeed it proved to be in the automobile industry.⁵¹ Doctrinally, there is no difficulty, all that is involved being a mortgage with power of sale in the mortgagor. And once the system is set up, there is no difficulty in bringing in the money-lender as assignee of the mortgage.

So much for seller-financed sales by means of chattel mortgages. The financing buyer is in certain fields—as cotton or textile factor,⁵² for instance—a familiar figure.⁵³ He makes his appearance in fields where the producing units are small and disorganized and only at the distribution level has the industry been, so to say, rationalized. His practice is to finance the incoming inventory for one or more of the processors who are his source of supply. Our law of sales is such that he cannot adequately protect himself against competing creditors or for that matter against other would-be buyers by means of a forward contract of sale, however artfully drawn and no matter how many provisions regarding allocation, segregation, marking and tagging may

already in the borrower-consumer's possession is outside the scope of this article. For the financing of sales to consumers see pp. 540, 546-8 *infra*.

50. In some jurisdictions, a mortgage involving a floating charge may be valid as a purchase-money mortgage, although invalid in any other situation. 2 GLENN, *op. cit. supra* note 11. Whether the rule is based on the possibility of policing set forth in the following sentence of the text is not clear from the cases.

51. Under trust receipts and not under chattel mortgage—but the principle was the same.

52. Traditionally a factor was one who sold goods on commission, whether or not he made advances to his principal. If he made advances, he had a well-established common-law lien on goods (and their proceeds) in his possession—the lien may be regarded as the natural result of a course of dealing on current account. Factor legislation today, however, often defines the factor as anyone who advances money on goods whether or not he is employed to sell them—*e.g.*, N.Y. PERS. PROP. LAW § 45.

53. See Steffen and Danziger, *The Rebirth of the Commercial Factor*, 36 COL. L. REV. 745 (1936). For the financing factor in a sixteenth century setting, see TAWNEY, *op. cit. supra* note 29, at 50 *et seq.*

be inserted.⁵⁴ Since presumably his very purpose in keeping himself distinct from the manufacturer is to insulate himself from the risks of the manufacturing enterprise, no contract of agency or for work and services would be a safe substitute for the inadequate sales contract. Thus perforce he must turn to one or another of the security devices.⁵⁵

If he chooses to secure his manufacturer's inventory by chattel mortgage, he is in a position substantially better than that of the chattel mortgagee who was only a financing party with no interest in the goods except as security: the transaction will ultimately be liquidated

54. The classic case is *Low v. Pew*, 108 Mass. 347 (1871): sale of "all the halibut that may be caught by . . . the schooner *Florence Reed*, on the voyage upon which she is about to proceed," part payment of \$1500 acknowledged. On return to port the entire cargo was seized in connection with bankruptcy proceedings instituted against the owners of the schooner. The court commented that "it is an elementary principle of the law of sales, that a man cannot grant personal property in which he has no interest or title. To be able to sell property, he must have a vested right in it at the time of the sale." *Id.* at 349. *UNIFORM SALES ACT* § 5(3): "Where the parties purport to effect a present sale of future goods, the agreement operates as a contract to sell the goods." See 1 *WILLISTON, SALES* § 128 ff (2d ed. 1924). For modern instances of the inadequacy of the forward contract of sale to protect the buyer, see *Ely & Walker Dry Goods Co. v. Adams Mfg. Co.*, 105 F.2d 906 (C.C.A. 2d 1939) (bankruptcy); *Gile v. Lasselle*, 89 Ore. 107, 171 Pac. 741 (1918) (resale to second buyer); *Pacific Wool Growers v. Draper & Co.*, 158 Ore. 1, 73 P.2d 1391 (1937) (resale by wool grower in violation of cooperative marketing agreement). There seems to be no authority in support of Judge Crane's dictum in *Proctor & Gamble Co. v. Peters, White & Co.*, 233 N.Y. 97, 104, 134 N.E. 849, 851 (1922): "It may be that upon the completion of manufactured goods, ready for delivery, title will pass to the purchaser by the intention of the parties, without any further act." *UNIFORM REVISED SALES ACT*, § 54 purports to tilt sales law considerably in favor of the financing buyer by giving him "as against any person but one purchasing in current course of trade a lien to the extent of the advance on any goods which have become identified as intended for the contract" whether or not appropriated or ready for delivery. The lien is restricted to the case where advances are made against "a particular production operation"; "one purchasing in current course of trade" is not defined. The Section will be discussed in Part II of this article.

Some states have statutes which give the financing buyer in particular industries a measure of protection, for example:

(1) Statutes which provide a technique for giving notice of the buyer's rights where seller must be left in possession.

(a) Recordation of bill of sale of wool growing on sheep: *WYO. COMP. STAT.*, c. 56, §§ 1301-4 (1945); *UTAH CODE*, tit. 33, c. 4, § 1 (1943).

(b) Branding of lumber with purchaser's brand: *TENN. CODE* § 6779 (1934); *VA. CODE*, c. 60, § 1453 (1942).

(c) Recordation of notice of sales of bulky articles: *N.H. REV. LAWS*, c. 262, § 45 (1942).

(2) Statutes which provide liens on crops for buyers supplying seeds, or financing the purchase of seeds: *W. VA. CODE* § 3933(1) (1943); *N. D. REV. CODE* § 35-0901 (1943).

55. Perhaps the chief means by which factor finance is carried on is assignments of accounts receivable, discussed briefly pp. 520-1 *supra*. In some states, of which New York is one, factors' advances may also be secured under so-called "sign statutes"—e.g., *N.Y. PERSONAL PROPERTY LAW* § 45—which provide for the posting of signs at the borrower's place of business stating the name of the factor and the fact that he claims a lien.

by the delivery of the mortgaged goods to him—the buyer-mortgagee—rather than by the application of the proceeds resulting from their sale to some third party. Thus, to the extent that he arranges to take the output of the mortgagor, the principal problem disappears.⁵⁶

The point at which the chattel mortgage showed itself least tractable in the attempt to force it into a modern industrialized pattern was where it was used as a device to finance the sale of goods still in motion. In the category of sales to a consumer for use, that fruitful source of difficulty vanishes: the goods are now at rest, there is a specific chattel to which the lien of the mortgage can attach and which will, so it is contemplated, remain in the mortgagor's possession for the duration of the loan period. No power of sale clause, no after-acquired property clause, no bug-a-boo of a floating charge on shifting stock is involved. The chattel mortgage is thus an entirely adequate instrument for financing consumer sales.

Before concluding our discussion, we should note one advantage, from the money-lender's point of view, which the purchase-money chattel mortgage does have over related devices. If a mortgagee, instead of holding the mortgage, assigns it along with a discount of the mortgage note, the assignee now has not only a holder-in-due-course claim on the note against the mortgagor and a derivative claim against the mortgagee on his indorsement of the note, but also is in the happy position of being able to enforce the mortgage—that is, proceed against the goods themselves—without regard to certain defenses between mortgagor and mortgagee arising out of the underlying sales contract. This freedom from defenses derives from the anomalous but familiar rule of law which states that a negotiable mortgage note "imparts" its own negotiability to the mortgage that secures it.⁵⁷ Thus the assignee

56. But see the transaction between financing livestock agent and cattle raiser reported in *Cudahy Packing Co. v. State National Bank*, 134 Fed. 538 (C.C.A. 8th 1904) in which the mortgage provided for shipment of the mortgaged cattle to the livestock agent 3 days before maturity of the mortgage note or if the cattle were consigned to and sold by a livestock agent other than the mortgagee, the proceeds were to be applied on the mortgage debt.

57. How great an advantage the stated rule of law gives the assignee is another question. Real defenses on the note or mortgage are of course not cut off in any event. Certain personal defenses, *i.e.*, non-delivery of the goods purportedly mortgaged, which the mortgagor may not plead in an action on the note leave the assignee in fact unsecured, since there is nothing to which his lien can attach. In such a case it is of course irrelevant whether he holds the mortgage "in due course" or not. The assignee benefits from the "imparting negotiability" rule principally where the mortgagor's defense is breach of warranty. For the small number of cases on this subject generally, see 2 JONES, *op. cit. supra* note 30, § 513. In the same section, footnote 10, the author lists a group of Illinois cases contrary to the majority rule; the cases are reinforced by statute. ILL. ANN. STAT., c. 95, § 26 (Smith-Hurd, 1935). Recent consumer sales legislation with a similar ban on chattel mortgage negotiability will be discussed in Part II of this article.

It is interesting to note that there are apparently no cases where the mortgagee has attempted to make the mortgage "negotiable" by a clause in the mortgage itself cutting off

of a chattel mortgage does achieve formally one of the goals of money-lenders in general: freedom from buyer-seller disputes.⁵⁸

Even in the field of financing consumer sales, where the chattel mortgage proved itself most adaptable, it has, in fact, largely given way to the conditional sale and kindred devices. The reasons for this loss of ground in its own bailiwick are largely discreditable to the money lenders; discussion of them will be deferred until we have briefly examined the nature of the conditional sale.

At the outset—for our purposes, the second half of the nineteenth century—the conditional sale was a very different thing from the chattel mortgage.⁵⁹ In the first place—and this distinction is still valid today—the permissible field of its use is more limited and defined than that of the chattel mortgage. The chattel mortgage is a protean device: it can be made to serve with more or less happy results in any situation where money is lent against tangible security.⁶⁰ The conditional sale, on the other hand, by definition must have its origin in a sale; as initial parties to the transaction there must be a seller and a buyer.⁶¹ Thus the conditional sale has never been available where the

defenses. See discussion of such cut-off clauses in conditional sale contracts, pp. 544-5 *infra*.

58. The commercial importance to the financing house of holding free from defenses in this situation may easily be exaggerated. If it were a question of importance there should be a sizable number of cases; in truth the cases are rarities and the doctrine is one that is honored principally in the dictum. Negotiability *rel non* is apt to be a lawyer's question, not a businessman's, and there is reason to believe that the banks and finance houses are relatively indifferent to whether their paper is or is not negotiable. On the other hand, the fact that the lawyer thinks the matter is an important one, even if his client does not, has a bearing on the outcome.

59. See Glenn, *The Conditional Sale at Common Law and as a Statutory Security*, 25 VA. L. REV. 559 (1939); 2 GLENN, *FRAUDULENT CONVEYANCES AND PREFERENCES* cc. 29, 30 (1940).

60. No one has ever successfully defined what a chattel mortgage is. Thus the New York Chattel Mortgage Law, wisely and typically, foregoes all definition and plunges *in medias res*: "Every mortgage or conveyance intended to operate as a mortgage of goods and chattels . . ." N. Y. LIEN LAW § 230. The draftsmen of the UNIFORM CHATTEL MORTGAGE ACT § 9(1) wrestled with the problem and produced a definition notable for its forthright use of the word "any": "*Mortgage* means any transaction by which a legal or equitable property interest in goods or book accounts is created in the mortgagee in order to secure the performance of any obligation or to indemnify the mortgagee against any obligation or loss, which interest is to terminate on satisfaction of such obligation or indemnity."

61. Thus, UNIFORM CONDITIONAL SALES ACT § 1: "In this Act Conditional Sale means (1) any contract for the sale of goods under which possession is delivered to the buyer and the property in the goods is to vest in the buyer at a subsequent time upon the payment of part or all of the price, or upon the performance of any other condition or the happening of any contingency . . ." § 1(2) includes in the definition contracts of bailment or lease, so-called, where the bailee or lessee pays the purchase price as "rent" and has the option of becoming the owner at the end of the bailment or rental period. In this article we shall not deal at any length with the familiar bailment-lease arrangement which was used either in jurisdictions, *i.e.*, Pennsylvania, where the conditional sale was not recognized, or elsewhere

initial parties are borrower in possession of goods and money-lender. To say that it is not so available is not to say that it has not been so used: the sequence in which the borrower executes an absolute bill of sale to the money-lender and takes back a conditional sale contract is not unknown. But the courts have been reasonably consistent, at least where the particular sequence has been found as the facts in the case, in identifying the chattel mortgage under the Hallowe'en mask. Thereafter the rights of the parties are adjudicated under chattel mortgage law—the customary result being that the unmasked mortgagee loses for improper or no recordation.⁶²

The restriction of the conditional sale to cases where there was an actual sale in the background has had significant results beyond its outlawry in the borrower-money-lender situation. No one has ever tried to use it to create the so much desired floating charge on shifting stock. The conditional sale contract with power of sale clause and after-acquired property clause as right and left bowers, and no-duty-in-vendee-to-account-to-vendor-for-proceeds-of-resale as the joker, was never invented. There is no particular reason why it should not have been; the drafting problems would have put no greater tax on legal ingenuity than those levied when the corresponding chattel mortgage form was drawn up, and, for all we know, it might have been worth a try. Still the monster never walked the earth, which is no doubt just as well.

The other original distinction between conditional sale and chattel mortgage has, as is common learning, today disappeared, largely as a result of remedial legislation. The mortgagee's rights, after default, have always been to sue the debt to judgment, foreclose, credit the proceeds of sale against the debt and claim as an unsecured creditor against the mortgagor for any resulting deficiency.⁶³ The conditional vendor at common law on the other hand, was put to his election: he could either sue his debt to judgment or he could repossess his security,

presumably to escape the cramping pressure as chattel mortgage law came to be applied to the conditional sale. Substantially our discussion of conditional sale may be applied, *mutatis mutandis*, to bailment-lease and kindred minor devices.

62. See *In re James, Inc.*, 30 F.2d 555, 557 (C.C.A. 2d 1929): "A conditional sales contract contemplated a vendor and vendee, not a lender and borrower of money." And consider the language of the court in *In re Sachs*, 30 F.2d 510, 512 (C.C.A. 4th 1929) (where borrower gave a bill of sale and took back a so-called "consignment contract"): ". . . the form as well as the substance shows that the transactions were mortgages to secure debts and not consignments—where personal property is transferred or assigned as security for a debt, the transaction will be regarded as a mortgage of the property, whatever the parties may have called it." Another illustrative case is *Adler, Salzman & Adler v. Ammerman Furniture Co.*, 100 Conn. 223, 123 Atl. 268 (1924). It will be remembered that N. Y. LIEN LAW § 230 includes not only every mortgage but also every "conveyance intended to operate as a mortgage. . ."

63. UNIFORM CHATTEL MORTGAGE ACT §§ 60-9 provides a statement of the law substantially as developed in the cases.

but he could not do both. If he sued on the debt, he lost his security and became a general creditor; if he repossessed the goods, he lost his deficiency claim.⁶⁴

The conditional sale started the race under a staggering handicap, since any money-lender worthy of the name will insist on having both the right to repossess and the deficiency claim—particularly since sale after repossession⁶⁵ regularly leaves a deficiency.⁶⁶ The principal early drive in the development of our conditional sales law was, consequently, to conform the conditional sale to the chattel mortgage in this vital respect. The judges, who knew their common law, were at first not amenable: where conditional sale contracts stipulated both for repossession and a deficiency claim, they might be found to be chattel mortgages on masquerade, or the offending clause might be disregarded as repugnant to the essence of the bargain.⁶⁷ In time, however, the judges put away their learning and went along with the expressed needs of commerce. First by case law and then by legislation the conditional vendor's right to be a chattel mortgagee where it suited him was almost everywhere acknowledged.⁶⁸

The conditional sale was in another respect less advantageous to the money-lender than the chattel mortgage in the situation where the vendor assigned the contract to a financing agent immediately upon sale. The anomalous rule, whereby a negotiable mortgage note imparts its own negotiability to the accompanying mortgage, has never been applied in the law of conditional sale.⁶⁹ It is quite possible in most jurisdictions to have a negotiable note referring to and secured by a

64. See generally 3 JONES, CHATTEL MORTGAGES AND CONDITIONAL SALES c. 31 (6th ed. 1933). Although arguing strongly against the result, the author concludes that, apart from remedial legislation, "it is regarded by a large majority of the courts of the country that these two remedies [*i.e.*, to retake the chattels or to sue for the purchase price] are inconsistent"; *id.* § 1309 (collecting cases). See further Note, 17 MINN. L. REV. 66 (1932); 2 GLENN, *op. cit. supra* note 11, § 513.

65. Doctrinally, the retaking vendor at common law was under no duty to resell, since he was merely retaking his own property on condition broken. Practically, however, he had to resell.

66. See, for some interesting figures on the amount of deficiency following forced sales in Pennsylvania in the 19th century, Skilton, *Assessing the Mortgage Debtor's Personal Liability*, 90 U. OF PA. L. REV. 441 (1942).

67. See 2 GLENN, *op. cit. supra* note 11, § 513. Thus as late as 1932 a federal court could write, with reference to the Michigan law: "Where an instrument specifically reserves title in the seller, the test . . . is whether the seller can retake the goods and then sue for the deficiency in the sale price. If he can do both, the instrument is a mortgage. . ." *In Re Berghoff Printing Co.*, 62 F.2d 493, 494 (C.C.A. 6th 1932).

68. Glenn, *op. cit. supra* note 11, § 513, is of the opinion that: "such a provision (*i.e.*, one allowing the vendor both repossession and deficiency) must be sanctioned by statute; otherwise the transaction amounts to a chattel mortgage, and must be treated as such," criticizing the Massachusetts decisions validating such a provision in the absence of statute as "irrational."

69. See discussion p. 540 *supra*.

conditional sale contract.⁷⁰ The note is indorsed and the contract assigned to the financing agent. As indorsee, the financier now has a holder-in-due-course claim against the vendee-maker. As assignee of the contract, the financier is still, however, subject to the vendee's defenses against the vendor. Thus when the financier attempts to realize on his security instead of, or in addition to, suing on the note, the vendee's contract defenses revive. A warranty claim, for example, which will be of no avail to the vendee if he is sued only on the note by a holder in due course will, once the chattel is repossessed and resold at a loss, cut down the recovery of a deficiency judgment against the vendee by the amount of the claim. Indeed if the amount of the warranty claim equals the unpaid balance of the purchase price, repossession of the chattel by the vendor or his assignee may be a conversion of the vendee's interest.⁷¹

The annoying persistence of contract defenses good against the third-party financier has never been successfully solved by counsel for the banks and finance companies. The indicated strategy would seem to have been to conform the conditional sale, in this respect also, to the chattel mortgage. The successful outcome of the deficiency claim plus repossession campaign would have increased the chances for this line of attack: if a conditional sale is enough like a chattel mortgage to allow a deficiency claim after repossession, why not also like enough to allow the security to move with the note in unchallenged negotiability? Curiously enough this line was never explored. Instead the attempt has been, to write a conditional sale contract which will itself be, or have the same effect as, a negotiable instrument.

A contract of sale can with difficulty be conceived of as a negotiable instrument, which must, among other things, "contain an unconditional promise or order to pay a sum certain in money."⁷² The buyer's contract promise to pay for goods delivered by the seller is conditioned on a variety of things: on the goods being delivered, on their being of contract quality, on their having no latent defects, and so on. Nevertheless, the desperate expedient of writing the entire conditional sale contract in one document, in form a promissory note, has been resorted to and at least on one occasion successfully.⁷³ It is unlikely however that such documents, if they came into common use, would meet with general acceptance. The line more frequently followed was to draft the

70. *Contra*: *Central National Bank v. Hubbel*, 258 Mass. 124, 154 N.E. 551 (1927). The proposed UNIFORM REVISED NEGOTIABLE INSTRUMENTS LAW will codify the majority rule.

71. Numerous cases stating the general propositions that warranty claims are available to the conditional vendee and that the assignee "stands in the shoes of" the assignor are collected in 2A UNIFORM LAWS ANNOTATED § 40 (Supp. 1947).

72. NEGOTIABLE INSTRUMENTS LAW § 1(2).

73. *Abingdon Bank & Trust Co. v. Shiplett-Moloney Co. et al.*, 316 Ill. App. 79, 43 N.E.2d 857 (1942).

conditional sale contract in such form that, although admittedly non-negotiable, the assignment to the finance company would cut off the vendee's defenses. This was sought to be done by inserting in the contract clauses by which the vendee acknowledged delivery of the chattel and represented to any assignee of the contract that he had no defenses against the vendor—whether of want or failure of consideration, fraud, duress and so on. Contracts of this sort sparked the well-known negotiability by contract controversy, which was generally, where litigated, decided adversely to the finance companies.⁷⁴ Despite the unfavorable court decisions, however, the finance companies continue to put at least a qualified faith in clauses of the type mentioned.⁷⁵

The availability of contract defenses against the assignee could, theoretically, give the vendee more than a claim in diminution of the purchase price. The hybrid nature of warranty actions, straddling contract and tort, makes the recovery of consequential damages particularly easy—and a personal injury claim arising from the use of the conditionally sold chattel may be many times greater than the purchase price.⁷⁶ The general willingness of the courts to accept disclaimer of warranty clauses at their face value⁷⁷ made the problem one susceptible

74. The cases are not many. Most frequently cited is *American National Bank of San Francisco v. A. G. Sommerville, Inc.*, 191 Cal. 364, 216 Pac. 376 (1923) (reversing judgment for plaintiff assignee, and remanding for new trial; defense raised was total failure of consideration). A recent case, holding a cut-off claim invalid as against public policy, is *Equipment Acceptance Corporation v. Arwood Can Manufacturing Co.*, 117 F.2d 442 (C.C.A. 6th 1941). A minority of the cases allows the cut-off clause to operate where the defense raised is breach of warranty or failure of consideration, indicating that the clause would be of no avail against such defenses as fraud, duress, etc. *Anglo-California Trust Co. v. Hall*, 61 Utah 223, 211 Pac. 991 (1922); *U.S. ex rel. Administrator of FHA v. Troy-Parisian, Inc.*, 115 F.2d 224 (C.C.A. 9th 1940). A distinction between breach of warranty as a defense which can be cut off and fraud as a defense which cannot seems untenable; most fact situations which can be called breach of warranty can equally well be called fraud. The distinction brings to mind, however, the negotiable instruments distinction between real and personal defenses. The point might be made that the cut-off clauses which specify fraud, duress and so on are attempting to put the assignee in a position which he could not attain even as a holder in due course of a negotiable note, free from real as well as from personal defenses. On the problem generally see Beutel, *Negotiability by Contract*, 28 ILL. L. REV. 205 (1933).

75. Thus the National Shawmut Bank of Boston, which does a large volume of consumer sale financing in New England, includes this well-drafted clause in its Conditional Sale Contract (Form No. 33-330): "Purchaser waives as against any assignee of the seller any defenses, set-offs or counter-claims Purchaser may be entitled to assert against Seller."

76. The danger to date seems to be theoretical only. The doctrine is clear enough, the assignee is generally solvent and available—the only thing lacking is cases. For a statement of the theoretical availability of the remedy, see 2A UNIFORM LAWS ANNOTATED § 31. Why no one has ever attempted to collect consequential damages from an assignee of a conditional sale contract is a puzzling question. Here again we are dealing with a question which doubtless seems more important to a lawyer than to a business-man—cf. the remarks made notes 3 and 58 *supra*.

77. Thus the New York Court of Appeals in a leading case, *Lumbrazo v. Woodruff*,

of a drafting room solution—and the conditional vendee today usually gets a document which puts him back in the good old days of *Chandeler v. Lopus*⁷⁸ or *McFarland v. Newman*,⁷⁹ or at the most offers a carefully framed warranty of limited application expressly stated to be in lieu of any and all other warranties.

It is apparent that, for the financier's money, the conditional sale was, in its original form, an instrument immensely inferior to the chattel mortgage even in the field in which it could properly be used. How then explain its astonishing success? The reasons, as suggested before, are largely discreditable. In the first place, and above all, the conditional vendee did not, at common law, benefit from any of the protection afforded the mortgagor; the buyer, even in conditional sale, was a buyer still and thus, under our common law of sales, something of a second class citizen. He had promised to pay and no equitable nonsense about it. If he had made twenty-three payments and defaulted on the twenty-fourth, what reason was there for the law to keep the vendor (or his assignee) from repossessing the chattel and forfeiting the payments made?⁸⁰ And since time is of the essence (to be on the safe side, the contract forms took care to make the point expressly down where the fine print begins) the slightest default was enough to mature the vendor's rights.

During the nineteenth century installment selling to consumers had been restricted, both as to the type of goods sold—pianos, expensive furniture—and as to the class of purchasers sold to—stable, relatively

256 N. Y. 92, 96-8, 175 N.E. 525, 527-8 (1931) (not a conditional sale case): "The parties in the disclaimer of warranty clause exercised a right and privilege expressly reserved to them by section 152 of the Personal Property Law [UNIFORM SALES ACT § 71]. . . . This clause was . . . made part of the contract: 'We give no warranty, express or implied, as to description, quality, productiveness, or any other matter, of any seeds sent out, and will be in no way responsible for the crop.' " [The seeds, sold as Japanese onion sets, proved to be an inferior kind of onion set.] "Neither party was obliged to enter into this contract, and there is no public policy which prevents adult persons of sound mind making such agreements as they please, not prohibited by statute, or contrary to natural justice and good morals. This court and other courts have recognized the validity of agreements limiting or excluding implied warranties." See Greenhalgh, *Disclaimer of Warranties*, 1939 WIS. L. REV. 459; Note, *Contractual Disclaimers of Warranty*, 23 MINN. L. REV. 784 (1939).

78. Cro. Jac. 4 (1625). Plaintiff alleged that defendant sold him a stone which he affirmed to be a Bezoar stone, whereas it was not a Bezoar stone. Held, in the Exchequer Chamber, that "the bare affirmation that it was a Bezoar stone, without warranting it to be so, is no cause of action."

79. 9 Watts 55, 57 (Pa. 1839) (sale of a horse with glanders, vendor having assured vendee that the horse was sound except for colt-distemper): "The fallacy of the question is in assuming that the [the vendee] ought to have any remedy at all. . . . He who is so simple as to contract without a specification of the terms, is not a fit subject of judicial guardianship. Reposing no confidence in each other, and dealing at arms' length, no more should be required of parties to a sale, than to use no falsehood; and to require more of them, would put a stop to commerce itself in driving every one out of it by the terror of endless litigation."

80. 3 Jones, *op. cit. supra* note 30, § 1382. In theory the forfeiture was justified as compensation to the vendor for loss of use of the goods during the time the vendee had them.

high income groups. About the turn of the century the range of articles sold on installment payment became more and more widely diversified, and the possibility of exploiting the lower income groups was perceived.⁸¹ When the typical conditional vendee became a factory worker, instead of a professional man, the chances of default somewhere along the line before final payment increased and multiplied. The vendor's power to repossess and forfeit under these circumstances opened magnificent new vistas of shady but strictly legal, profit. By selling and repossessing the same article several times over, it was possible to take several times the original sale price.⁸² And this was done.

Another advantage of the conditional sale over the chattel mortgage, which has been often pointed out as explaining its rise to fame—that is, its original freedom from the recording statutes—seems to us of much less importance than the power to forfeit payments made. The insistence in our literature on the lender's small-boy delight in keeping his lien secret has been overdone. The lender much prefers substance to shadow, and the substance where consumer sales were concerned was the ability to realize on the security without equitable let or hindrance. To be spared the bother of recording was to have frosting on the cake, but, even without the frosting the cake was palatable enough.

The ideal version of the conditional sale projected by counsel for the financiers—an arrangement for giving the vendor, and more particularly, the vendor's assignee, all the rights and almost none of the duties of a mortgagee—was too good to be true, or, at least, too good to last. Having by self-help won the right to a deficiency claim, they soon found themselves forceably obliged to accept the vendee's right, after repossession, to an accounting for payments made.⁸³ At this point they were back substantially where they had started, having accomplished nothing in the interim except the transformation of the conditional sale, originally, as we have seen, a well-differentiated security device, into something so like a chattel mortgage that merely human eyes were no longer able to see any difference.

We have impliedly set out discussion of the development of conditional sales law against a background of sale to the ultimate consumer for use. The law takes no distinction between consumer and consumer, and we have, at this point in our argument, taken none. We need not, however, ignore the fact that the various pressure devices used by conditional vendors and the finance houses in distributing consumer goods

81. See 1 SELIGMAN, *THE ECONOMICS OF INSTALMENT SELLING* c. 2 (1927).

82. One abuse was that a new article would be inspected by the customer at the showroom and presumably sold; but the article actually delivered would be secondhand. 1 SELIGMAN, *op. cit. supra* note 81, at 21. Such a practice was of course ground for rescission, but another advantage of dealing with the lower-income groups is that they are not inclined to litigate their rights.

83. UNIFORM CONDITIONAL SALES ACT §§ 18-26. Well over half the states have requirements for an accounting by statute or case law.

to the low income groups were not available, to nearly the same degree or at all, when rolling stock, machinery and fixtures were conditionally sold to railroads, manufacturers and merchants. The law was the same, but where the balance of economic power shifted a different contract form came out of the hopper. The manifold abuses of the conditional sale device are found principally in connection with the sale to the individual consumer and to such underprivileged enterprisers as the owners of corner grocery stores.⁸⁴

As has been pointed out, the conditional sale was by nature unavailable for third-party financing of goods in the borrower's possession, and equally unavailable for buyer-financed sales. For seller-financed sales to dealers for resale it worked as well as and, indeed until the statutory fusion of the two forms had been achieved, better than the chattel mortgage. The fusion was, however, achieved and the promised advantage disappeared. Thus we need not repeat our previous discussion of the chattel mortgage and its working in the sale to dealer for resale context.

The upshot of a half-century of tinkering with chattel mortgage law and conditional sale law was the working out of a fairly satisfactory system for financing consumer sales—fairly satisfactory from a functional point of view, although it became a stench in the nostrils of the legal scholars. What made the situation fairly satisfactory was that, as things worked out, there came to be really only one way of financing consumer sales. The abuses of the system, such as the inflated "service charge", were extreme but they were on the surface, readily identifiable and could be corrected by direct legislative action.⁸⁵ What made the scholars hold their noses was their discovery of the continuing legal fiction, not really annoying except to a theoretician, that two things which purported to be different were Chinese copies of each other.

Chattel mortgage and conditional sale—whether in their original forms or in their ultimate state of fusion—had been on the whole inadequate instruments for solving the highly important problem of financing the intermediate sale of goods in motion. The cause of the failure successfully to adapt them lies in the conservative, traditional nature of the legal process; the past, once encrusted on, cannot be easily sloughed off. A new instrument with a new name was needed, which would be designed on the particular reference to the problems which had proved insuperable when attacked by means of the traditional security forms and which would not come trailing clouds of ancient learning to confuse bench and bar alike.

84. There are more states today with provisions for an accounting after default in conditional sales of railroad rolling stock than there are with such provisions for general consumer conditional sales.

85. Which is not to say that they were. Part II of this article reviews the corrective legislation.